

City of Lafayette/Lafayette Redevelopment Agency Staff Report

For: City Council/Redevelopment Agency

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Subject: **Recommendation of the Senior Housing Task Force for the City to Apply for a State HELP Loan for the Purpose of Supplementing the Funds to Purchase a Site for the Senior Housing Project**

Purpose

1. To update the Council/Agency on efforts to assemble funding for the senior housing project.
2. To direct staff to work with Eden Housing, Inc. to apply for a HELP loan from the State to purchase the site.
3. To consider acquiring the remaining site and work in partnership with Eden Housing to build a mixed use project.

Background

On December 10, 2007, the City Council/Redevelopment Agency Board approved a predevelopment loan agreement with Eden Housing, Inc., the developer of the senior housing project. At that time, staff indicated that the financial analysis showed there is still a shortfall of some \$1.4 million for the project, which can largely be attributed to the unexpected high cost of the land – about \$5 million per acre.

The purpose of this memorandum is to provide the Council/Agency with background on the financing of the project and the recommended solution to address the projected gap. The issues summarized in this memo were discussed by the Senior Housing Task Force at its meeting of December 6, 2007. Further, the City's financial consultant, Mark Curran, and Administrative Services Director, Tracey Robinson, have also provided key input on the various options available to the City.

Development Funding Sources

To begin the discussion, it is useful to understand a little about the two main outside funding sources for this project.

HUD Section 202 Supportive Housing for the Elderly Program

HUD provides capital advances to finance the construction, rehabilitation or acquisition with or without rehabilitation of structures that will serve as supportive housing for very low-income elderly persons, including the frail elderly, and provides rent subsidies for the projects to help make them affordable. These interest-free capital advances are provided to private, nonprofit sponsors to finance the development of supportive housing for the elderly. The capital advance does not have to be repaid as long as the project serves very low-income elderly persons for 40 years.

Project rental assistance funds are provided to cover the difference between the HUD-approved operating cost for the project and the tenants' contribution towards rent. Project rental assistance contracts are approved initially for 3 years and are renewable based on the availability of funds.

Private nonprofit organizations can apply to develop a Section 202 project if they can, among other requirements, submit a resolution that they will provide a minimum capital investment equal to 0.5 percent of the HUD-approved capital advance, up to a maximum of \$25,000 for national sponsors or \$10,000 for other sponsors. Public entities are not eligible for funding under this program.

Low Income Housing Tax Credit

The California Tax Credit Allocation Committee (TCAC) administers the low income housing tax credit, authorized to encourage private investment in affordable rental housing for households meeting certain income requirements. The program replaced traditional housing tax incentives, such as accelerated depreciation, with a tax credit that enables low-income housing sponsors and developers to raise project equity through the sale of tax benefits to investors.

Two types of federal tax credits are available and are generally referred to as nine percent (9%) and four percent (4%) credits. These terms refer to the approximate percentage of a project's "qualified basis" a taxpayer may deduct from their annual federal tax liability in each of ten years. From the total ceiling amount available to California, CTAC allocates credit amounts based upon assessments of eligible project costs. The housing sponsor uses or sells ten times the allocation amount, since investors can take the annual credit each year for a ten-year period. Although the credit is taken over a ten-year period, the Internal Revenue Code requires that the project remain in compliance for at least 30 years.

Only rental housing projects are eligible for tax credits. Credits can be allocated to new construction projects or existing properties undergoing rehabilitation. Nine percent credits are allocated on a competitive basis so that those meeting the highest housing priorities and public policy objectives, as determined by the Committee, have first access to credits. Those utilizing tax credits must own the project for which the credits are awarded.

The program has both rent and income restrictions. Rents on tax credit units cannot exceed 30% of an imputed income based on 1.5 persons per bedroom (i.e., in a two-bedroom unit, the income of a three-person household is used to calculate rent, regardless of the actual family size of the household). Federal law requires that the initial incomes of households in tax credit units not exceed either 60% or 50% of the area median income, adjusted for household size. When a project developer or sponsor applies for tax credits, he or she irrevocably elects one of the following minimum federal set-aside requirements:

- a minimum of 40% of the units must be both rent-restricted and occupied by households whose incomes are 60% or less of the area median gross income, adjusted for family size, or
- 20% of the units must be both rent-restricted and occupied by households whose incomes are 50% or less of the area median gross income, adjusted for family size.

Under federal law, credit projects must remain affordable for at least 30 years; however, California law generally requires a 55-year extended use period for 9% tax credit projects. Also, 4% tax credit recipients frequently access significant boosts to their basis limits by agreeing to 55-year extended use restrictions. Regulatory agreements are recorded against each tax credit project to ensure compliance.

Most credits are sold to corporate or individual investors through public or private syndication. Investors benefit from the tax credit by purchasing an ownership interest in one or more tax credit housing projects. In turn, investors claim a dollar-for-dollar credit against their tax liability over a ten-year period. Partnership equity contributed to the project in exchange for the credit typically finances 30-60% of the capital costs of project construction. The net amount of equity proceeds contributed to a project is based on investor contributions (the present value of the ten-year credit) less syndicator overhead and fees and other syndication-related costs.

In 2000, federal law changed so that both tax credits and HUD 202 could be used together on a single project. However, the law requires that the general partner on the project (as opposed to the limited partners, the investors) be a nonprofit.

Current Project Cost

As many are aware, development costs are extremely high in the current economic environment, perhaps more so than anyone really expected. The land costs alone are dramatically higher than what the City anticipated, making this an extremely expensive project no matter how it is structured. Based on the current financial analysis from the developer's economics consultant, the total project costs can be summarized as follows:

SOURCES	PROJECTED AMOUNT	COMMENTS
HUD 202 Capital Advance	\$6,344,015	Only source of permanent financing allowed
Contra Costa County CDBG	\$2,000,000	County contribution
Contra Costa County HOME	\$1,000,000	County contribution
City of Lafayette	\$2,200,000	Current City commitment; represents approx. \$43,000 per unit
Affordable Housing Fund (AHP)	\$382,500	
Inclusionary Contribution	\$800,000	
Low Income Housing Tax Credit-General Partner Contribution	900,000	Funded from a portion of the developer cost, below
Low Income Housing Tax Credit-Limited Partner Contribution (4% Credit)	6,982,790	Tax credit financing
Total Sources	\$20,609,305	

USES	PROJECTED AMOUNT	COMMENTS
Site acquisition, relocation, demolition, etc.	5,695,348	
Architecture, engineering and testing	872,967	
Construction	10,404,460	
Permits, fees, legal costs, appraisals and other soft costs	1,961,920	
Developer fee	1,800,000	Established by formula by Tax Credit Allocation Committee; some of these funds are used as equity returned to the project as well as reserves
Financing and carrying costs	1,148,898	
Tax credits/syndication expenses	99,353	
Total Uses	\$21,982,946	
SHORTFALL	(\$1,373,641)	

Based on this table, there currently exists a projected shortfall of about \$1.4 million for which there does not currently exist a funding source. Acquisition costs alone represent more than \$101,000 per unit (if relocation and site expenses are included, the cost is about \$112,000 per unit). According to the financial analysis, all outside funding sources are maxed out at their projected amounts. One of the major difficulties facing the City is that federal Department of Housing and Urban Development rules do not allow the development to incur other permanent debt, meaning that the developer cannot itself take on additional funding for which it would be indebted. And, Eden Housing indicates that even if this project qualified for the 9% tax credit (the more competitive of the two kinds of tax credit projects; this project does not currently qualify because of the site location), it most likely would not provide much more in the way of funding.

The Senior Housing Task Force discussed four alternatives to this problem:

1. The City provides no additional funding other than the \$2.2 million already committed. This kills the project, since there are no other funds available from outside sources for this purpose.
2. The City provides additional funding in the form of bonded future tax increment. We have discussed this before; issuing a bond for just the additional amount may be very expensive considering the cost, but issuing a bond concurrently with the library bond may be too late in the process to use it for acquisition and other predevelopment costs.

3. The City provides the funding in the form of a HELP loan from the State. As noted before, the City makes the application for the HELP loan, not the developer (though Eden will help us with the application). HELP funds are available to a local government entity as an unsecured loan from CalHFA for up to 10 years at 3.5% simple interest per annum, and carry minimal restrictions and conditions. Repayment is backed by the general obligation of the local government entity and is required, in full, no later than 10 years from the date a loan agreement is executed. In this scenario, the City would repay the obligation through its Redevelopment Housing Setaside funds.

4. The City purchases the land itself and leases it back to Eden for some nominal amount. This scenario allows the City to retain the asset of the land in perpetuity, and would require the City to issue a bond against future tax increment. Although timing-wise it may not be able to implement this type of scenario immediately, considering how far along Eden already is in the process, the City may consider purchasing the land back at some future time. It should be noted that this scenario would require the City to provide additional monies beyond that envisioned in scenarios #2 and #3 above, since the purchase price is currently well above \$5 million.

Considerable discussion has taken place with respect to the City purchasing the site itself, both by the Senior Housing Task Force and consultants in dialogue with City staff. A number of significant challenges exist with this option, not the least of which is the complex legal structure that would be required. The City will need to develop sophisticated agreements that cleave the land from the project but maintain their connection as a whole entity. This is not something that most jurisdictions have expertise at doing; as far as is known, only San Francisco does their affordable developments this way. Considering the multiple funding sources involved, as well as the specific (and often contradictory) requirements among them, great care and attention will be required to ensure the complicated transaction is secure. Issues of how compliance will be handled, how the project will be secured, etc. will need to be worked out.

At the December 6th meeting of the Task Force, Eden offered a solution that would accomplish the City's goal to have control over the project at the end of the regulatory period. Basically, subsequent loan agreements would include language that give the City the right of first refusal at the end of the 55-year affordability restrictions for \$1 plus whatever debt is still outstanding on the property, if any. Since at that time the value of the property would principally be in the land, this scenario ostensibly gives ownership of the land back to the City. If Eden or some other entity wants to maintain the property as affordable housing at that time, it could still be used for this purpose. The Task Force and consultants supported this scenario as an easier fix to the problem of retaining control than actually structuring the project now with split ownership.

In addition, the recommendation from both the Task Force and consultants is for the City to apply for a HELP Loan from the State to assist in the purchase of the site. In this scenario, the City/Agency applies for the loan directly from the State (see #3 above).

Developer Fee

It is helpful to understand how Eden is paid for this project. Sometimes called "Developer Overhead/Profit" in tax credit parlance, the developer's fee (shown in the table on the second page as \$1,800,000) is compensation to the developer for the time and risk involved to develop the project. In California, this includes funds paid at any time as compensation for developing the proposed project, to include all development consultant fees, processing agent fees, developer overhead and profit, construction management oversight fees if provided by the developer, personal guarantee fees, and reserves in excess of those customarily required by multi-family housing lenders.

In the case of Tax Credit projects, the developer fee is established by formula by the State Tax Credit Allocation Committee (TCAC). For 4% projects such as the one anticipated by Eden, the maximum developer fee that may be included in project costs is the lesser of 15% of the project's eligible basis (that which is eligible to receive the tax credit for its investors) or \$2.5 million. The amount shown on the table above is essentially set by the State.

A large portion of the amount is returned to the project as a source of equity for the project. In addition, some of the remaining funds are held in reserves by the developer. Lenders typically want to see that there are funds available in project reserves to ensure that, should some problem exist with cash flow and/or government payments (such as a delay in reimbursement because of funding cycle conflicts), there is enough buffer available to weather temporary problems. Typically, a portion of the developer fee is deferred and remains as the reserve. The State has specific requirements on how the reserve is calculated; according to TCAC, operating reserves are funded in an amount equal to three months of estimated operating expenses and debt service under stabilized occupancy. Additional funding may be required if withdrawals to the reserves result in a reduction of the operating reserve account balance to 50% or less of the originally funded amount.

In the end, while the developer fee can appear quite large, in reality the amount directly going to the developer is relatively small – basically the cost of doing business, to pay salaries, etc.

Recent Updates

At the time of the December 10th meeting of the City/Agency to approve the predevelopment loan agreement, only the Conti Buick site was under consideration. Since that time, Eden Housing has had several discussions with a neighboring site, owned by the Lemos Family Trust. The Trust has also become interested in negotiating the sale of its property. The following summarizes key issues and opportunities with this second site:

- + The Lemos site is less than an acre – approximately .8 acre.
- + Based on current zoning of 35 units to the acre, even with State-mandated density bonuses it is not clear whether the project could achieve the optimal number of units to be operationally efficient. The maximum density bonus available is 35% over the base zoning, which translates to about 38 units total on the site, well short of the minimum needed by Eden to make a project pencil out (45 units). The following are some important caveats:
 - Nothing in the law precludes the City from granting more density than the 35% over base. The City could, at its discretion, decide on whatever evidence it wants that it will give this project (or any senior project, or any project) more than the 35%. Technically, this would not require a General Plan Amendment because the base density does not change. The City Council opted not to adopt its own density bonus ordinance some time ago, so it is unclear how this option could be implemented without going back to the Council with either a policy change or an outright density bonus ordinance.
 - The density bonus law requires jurisdictions to provide “concessions” to developers who want them, based on a formula, for projects that provide X amount of affordable. In addition, a jurisdiction can provide “waivers” of certain provisions, including zoning provisions, if it deems it necessary to allow the project to work. Conceivably one could argue that a density bonus above the 35% could be a “waiver.” However, this might be construed as somewhat nonsensical since it makes the whole threshold of 35% moot.

→The senior housing overlay General Plan Amendment that staff have been working on would provide the needed density for the senior project on the Lemos site. However, creating an additional density bonus noted in #1 may obviate the need for such a GPA since the underlying zoning does not change.

+ Although the cost of the Lemos site is less than the purchase price for the Conti site, the Lemos site's constraints will require the construction of podium parking, which increases the construction cost of the project to the point where the overall cost of the two projects would be roughly the same.

+ Because of this, Eden would still be looking for a shortfall of between \$1.4 and \$1.5 million. However, instead of being an acquisition shortfall, it would be a construction shortfall, which could not be paid for with a State HELP Loan.

At the November 13, 2007 joint meeting of the Planning Commission, City Council and Design Review Committee discussed the Conti site's potential for development. Interest was expressed in undertaking a lot line adjustment between the Conti and Lemos sites, so that retail development could occur along the Mt. Diablo frontage and residential development could take place at the rear of the site.

There appears to be some possibility of undertaking this endeavor since the Lemos site owners are in fact interested in selling the property; however, such an effort may prove complicated. If the City wishes to purchase the Lemos site separately, the City's General Fund (parking fund and City offices fund) can loan the funds to the Agency. The RDA can then purchase the Lemos site, complete a lot line adjustment, and then issue a request for proposals for a commercial developer to work in partnership with Eden to build a mixed use project. The developer will pay the RDA, which will in turn repay the General Fund.

An alternative might be that the RDA works with Eden alone for a larger senior project. While this certainly is appealing, there is concern that a larger project would be more difficult to fund without sources, given current resources constraints.

The City may also consider bonding against future revenues. If this option is deemed viable, staff recommends that the City wait until September when the tax rolls are adjusted. There have been several transactions involving large developments or properties in the downtown this year, and the City could benefit from an increased assessed valuation. It will take approximately three months to realize the money. This certainly is a feasible option and may provide more flexibility in how the City financings a senior project. However, tying up currently available RDA funds for the senior project in order to issue a bond may mean that Eden's current funding applications will expire because local funding is not in place when it needs to be.

One solution: So as to purchase both properties in a timely fashion, the City could make a bridge loan to the RDA of \$3.7M, using Parking and City Offices Funds. The RDA would then issue a housing bond this fall and repay the City. This would not impact the City's emergency reserve and, since the City has no immediate need for the Office or Parking Funds, have no or minimal impact on the City's liquidity. If the Agency is interested in acquiring either the Conti or the Lemos site, it may wish to declare its interest in doing so at the January 28th meeting and adjourn to closed session to discuss the terms and price.

With a larger development on a combined site, there is a possibility that such a project may run up against the proportionality test for Redevelopment funding of senior housing developments. Currently, only about 44% of the City's RDA set-aside funds for affordable housing can be used over the life of the Implementation Plan for senior housing. Assuming that \$15 million in increment is deposited into the set-aside account, the City would only be able to spend about \$6.6 million over the life of the Plan for senior projects. At this time, it is unclear how much the City might need to spend for a senior project on

the combined Lemos-Conti site, since no proforma has been created for such a scenario, but it is conceivable that the City could have problems funding a project of this magnitude.

The prospect of developing the entire two-acre site is appealing because it would enable the City to produce a higher quality development for downtown Lafayette and more affordable units. But, because the expanded scenario would require time to complete the transaction and design development processes, it will jeopardize Eden's current funding applications for County and the US Department of Housing and Urban Development funds. The application already before the County assumes an option on the Conti site only, and must be executed by the end of this month in order to remain viable.

Furthermore, HUD applications are by early June, and full site control will be required. A development that anticipates a larger or reconfigured site will likely not meet the site control test. This is true whether the project envisions a larger site or a lot line adjustment. The purchase of the additional site and the lot line adjustment would thus have to be concluded before June in order for this scenario to be feasible, which is an exceptionally aggressive and perhaps impossible timeframe. In other words, if the City seeks to incorporate both sites project financing and development would likely be delayed for at least one year. That tradeoff may or may not be worth the effort.

At its meeting on January 14th, the Senior Housing Task Force discussed the two sites' pros and cons, following a presentation by the architect Rick Williams. The Task Force was pleased to learn of the second option, but expressed concerns about the timing. Because of the tight timeline to get the HUD application filed, Eden impressed upon the task force the need to have an agreement signed before the end of January. Since Eden has two proposals out, it was suggested that Eden accept the first counteroffer and not wait. If Eden is successful purchasing one property, and another developer the other, the Task Force agreed that there is the potential to do a rearrangement of lots and coordinate design efforts. However, there was no preference expressed for one site over the other for the eventual senior affordable housing project. While the pros and cons of each site was discussed, the Task Force agreed that neither seemed to have an overwhelming advantage.

Conclusion

Staff notes that, while the Senior Housing Task Force is singularly focused on delivering affordable senior housing, the Agency Board is charged with a broader mission, one that, in addition to affordable housing, includes downtown revitalization, urban design, and retail development. The larger focus may lead to a different, two-parcel conclusion.

Eden Housing has continued to dialogue with the owners of the Conti site; at the time of this writing, Eden expects to have a signed purchase agreement on the site prior to the January 28th meeting.

Recommendation

Approve the City's application to the State for a HELP loan for the purchase of the Conti Site. Consider acquiring the remaining site and work in partnership with Eden Housing to build a mixed use project.

Attachments

Location map

